Unit 4: Non-traditional Procurement Routes

4.1 Introduction

This Unit reviews the most common non-traditional procurement options available in the UK construction industry and with application worldwide. Students with experience in construction may feel confident in their procurement knowledge. However past experience shows that such students’ knowledge can be confused or unclear and an opportunity to revise and update and re-appraise is often very necessary.

There are three generally accepted standard approaches to construction procurement in the UK: traditional procurement; design and build/construct procurement; and management procurement. These alternative contract arrangement options often called procurement routes (or paths), vary in the way they operate for clients. Each method is ideal for some of the client’s priorities while being weaker or less effective in others. No procurement path is best suited in all circumstances. This unit deals specifically with the non-traditional procurement options available within the UK construction industry at present. The preceding Unit has dealt with the traditional procurement route. This unit will deal with the non-traditional procurement options with reference to the structure of the procedure and the allocation of responsibility and liability between the Employer and the Contractor.

This Unit will also refer to a number of other procurement routes which have been supported and encouraged by the government in relation to public authority sponsored projects. These procurement methods include: private public partnerships (PPP); private finance initiative (PFI); prime contracting; and partnering.

4.2 Selecting the right procurement route

In any project process one of the key elements is the selection of a suitable procurement method for the implementation, design, construction and completion of the project. This key decision will be made arising out of the strategic brief for the project. The key elements being considered at this stage in addition to the procurement arrangements are as follows:

- Procurement arrangements;
- Arrangements for decision making and communication; and
- The allocation of risk between the contracting parties.
The selection of the right procurement route is critical to project success. In addition to the traditional route, further ways of organising the design and construction processes must be considered to ensure that each client’s individual set of requirements are met. There is no “one size fits all” solution for construction projects. Every client is different, and the needs of the same client can change over time. The client’s requirements for both the design of the building and the way in which it is required to be delivered must be critically evaluated to inform the selection of the right procurement route.

There are eight basic issues that should be considered when selecting a procurement route [1]. These are:

1. **Factors outside the control of the project team**, such as changes in finance costs and the availability of required skills from the construction industry.
2. **Client resources**, including the experience and knowledge of the people within the client organisation who will be interacting with the project.
3. **Project characteristics**, such technical complexity and its likely influence on possible cost and time overruns.
4. **The need to accommodate changes**, and the extent to which the client is willing to exchange cost certainty for the ability to continue to accommodate changes in later project stages.
5. **Risk management**, and the need to ensure that risk is distributed to those organisations best able to manage it so that excessive cost is avoided.
6. **Cost issues**, including the level of cost certainty required at each stage of project progression.
7. **Timing**, including whether or not the project is to be delivered in whole or in a phased handover and the impact of late (or early) handover on the client’s business.
8. **Quality and performance**, focusing on the need to ensure the building provides the required functionality and is not over or under specified.

Working with advice from construction industry members as necessary, it is important for the client to ensure that the procurement route is both [2]:

- suitable in light of the client’s needs, the project type and the client’s exposure to risk; and
- feasible in the light of the client’s expertise, internal management structure, resource and funding facility.

In addition to the above, the client may wish to think more generally about the type of relationship it wishes to form with the construction industry. If it is, or intends to become, a repeat client then a partnering or other collaborative approach to procurement could be appropriate. Alternatively, it may wish to secure the benefits of improved efficiency and value resulting from using similarly collaborative working methods on a one-off project. The client’s ability to adopt such an approach depends on its capacity to quickly establish
trust with construction industry members to build an “open book” working relationship. In these relationships, clients must also be willing to share the gains (as well as any pain) arising from the project with construction industry partners.

Only once all of the above has been considered in a structured and systematic way can the right procurement route be selected for each client’s specific needs, on each project.

4.3 Types of Procurement Route

The selection of a procurement route for each project is simplified by the availability of several standard arrangements, and construction industry members’ familiarity with them. These can be thought of as comprising two categories of procurement route:

- **Established procurement routes**, which have been successfully used in the construction industry for many years and have evolved from its ongoing practice; and;

- **Integrated procurement routes**, which have emerged in recent years in response to construction industry initiatives and changes in client requirements.

4.3.1 Standard procurement routes

Key established procurement routes are:

- **Traditional**, in which the design is fully completed by the Employer’s consultants before contractors tender (usually competing on price alone) for, then carry out, construction.

- **Design and Build**, in which detailed design and construction is undertaken by a single contractor for a lump sum, allowing design and construction to overlap if required. Where a concept design is prepared by the Employer before the Contractor is appointed to finish and construct that design, the procurement route is called Develop and Construct.

- **Construction Management**, in which the design is developed by the Employer’s consultants and construction commences before the design is complete. A fee-earning consulting “Construction Manager” works for the Employer to define and manage several Works Packages, each representing a specialised or functional aspect of the project. All contracts are between the Employer and the trade contractors. The final cost of the project may only be accurately known when all the packages have been let.

- **Management Contracting**, in which the design is developed by the Employer’s consultants and construction commences before the design is complete. A “Management Contractor” is appointed early to let elements of work progressively as a series of trade or package contracts (called ‘works packages’). The contracts are between the works Contractors and the Management Contractor. As with Construction Management, the final cost can only be determined when the last packaged ah has been let.
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- **Design and Manage**, in which outline design is completed by consultants in the manner of Management Contracting, but detailed design is led by the Management Contractor. Design and construction overlap.

### 4.3.2 Integrated procurement routes

Integrated procurement routes simplify procurement from the Employer’s perspective as they provide a unified interface between the construction project and the Employer’s organisation. As a consequence of historically poor management of the risks arising from Employer’s retention of control over much of the project, public sector clients are now advised to procure construction projects from one of the three routes characterised by a single point of responsibility interface with the client. The Office of Government Commerce states that “[established] procurement routes should only be used if they demonstrably add value in comparison to the three recommended routes.” [3]. These ‘recommended routes’ are summarised in Table 4.1.

<table>
<thead>
<tr>
<th>Procurement Route</th>
<th>Key Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>PFI</td>
<td>Where the public sector contracts to purchase quality service, with defined outputs from the private sector on [a] long-term basis, and including maintained or constructing the necessary infrastructure so as to take advantage of private management skills incentivised by having private finance risk.</td>
</tr>
<tr>
<td>Prime Contracting</td>
<td>Using a single contractor to act as the sole point of responsibility to a public sector client for the management and delivery of a construction project on time, within budget (defined over the lifetime of the project) and for the purpose for which it was intended, including demonstrating during the initial period of operations that operating cost and performance parameters can be met in accordance with a pre-agreed cost model.</td>
</tr>
<tr>
<td>Design and Build</td>
<td>Using a single contractor to act as the sole point of responsibility to a public sector client for the design, management and delivery of a construction project on time, within budget (taking according of whole-life costs) and in accordance with a pre-defined output specification using reasonable skill and care.</td>
</tr>
</tbody>
</table>

Table 4.1: Integrated procurement routes preferred by the Office of Government Commerce

Students should note that Design and Build is also an established procurement route as it has been used with considerable success for many years. Prime Contracting is very similar to Design and Build procurement.
4.4 The ‘Design and Build’ procurement route

The Design and Build procurement route is characterised by the development of tender documents which describe the Employer’s Requirements, but do not provide a fully developed design solution before the Contractor is appointed.

**Advantages**
- The client liaises with a single point of contact and responsibility
- Inherent buildability
- Firm price available prior to construction
- Reduced total project duration when compared to traditional routes
- Contractor’s design liability can be extended to include fitness for purpose

**Disadvantages**
- Client needs to appoint Contractor before design is complete
- No design overview unless consultants are appointed
- Difficult for clients to prepare adequate brief
- Bids are difficult to compare
- Design liability limited by standard contract
- Client driven changes can be expensive

**Sequence (not to scale)**

- Brief
- Competition
- Design
- Construction

**Risks**
- Low cost risk as most contracts will be let on a lump sum basis
- Low time risk as the design and build contractor will usually fix the time and be committed to it
- High design/quality risk as when the design and build contractor controls the design there are risks related to both design suitability and to the capacity of the design and build contractor to perform such tasks.

**Figure 4.1: Typical project structure under the Design and Build procurement route**
The Design and Build Contractor provides a single point of responsibility to the Employer for delivering to time, cost and stated quality, thereby simplifying the process from the Employer’s perspective. However, Design and Build offers little flexibility for making changes, which can be both costly and have programme implications. Once the parameters are set, there is little opportunity to make changes. The arrangement requires Employer discipline and a clear statement of its requirements at the outset.

The Design and Build method is used increasingly as a means of managing the building process in the UK and around the world. It allows the Employer to know its total financial commitment early in project life (provided that changes are not required during the course of the works).

The Contractor is responsible for design, construction planning, organisation and control. These activities can proceed concurrently to a greater extent than is possible with the Traditional system, although the traditional route to assume some characteristics of fast track construction when required.

The Design and Build Contractor may be able to provide a comprehensive package comprising site seeking, and purchase, obtaining planning permission and building regulations approval, financing facilities, leasing, and so on. The Design and Build approach is suitable for the following:

- all clients, including inexperienced ones and those who do not want close involvement;
- those desiring cost certainty;
- fast track projects; and
- simple buildings.

Some argue that Contractor’s concern with simplifying construction activities can lead to a reduction in design quality and makes Design and Build inappropriate for complicated projects or projects in which a sophisticated design solution is required.

Work on the building can commence as soon as local authority approvals have been obtained and sufficient information regarding the earlier site operations is available. The design does not need to be finalised before at least some of the work can commence. The nature of Design and Build promotes integration of the design and construction team. The closer involvement of contractors in the design process should lead to designs that can be more easily built (i.e. improve buildability).

With the Design and Build method, there is no architect or similar professional available to the Employer to advise on the technical quality of the designs at the time of tender, although the Employer is not precluded from seeking advice. The Employer’s agent may supervise the works and ensure that the Contractor’s proposals are complied with and the work is of the required standard.

The nature of this procurement route tends to reduce changes (variations) from the original design (because design is under the Contractor’s control) and disruption of the works is less likely to occur. This produces time and cost savings that benefit the Employer and the total project completion period is reduced. Time savings reduce the client’s financing charges, inflation has less effect and the building is operational sooner, which, in
a commercial context, produces an earlier return on the capital invested. As illustrated by Figure 4.2, the Design and Build procurement route is currently used most often for larger projects.

Figure 4.2: Distribution of Design and Build use, by contract value [4]

4.4.1 Variations of design and build

Several variations of the Design and Build procurement route exist, each offering a different distribution of risk between the Employer and the Design and Build Contractor due to the assumption of different responsibilities:

Package deals and Turnkey solutions:
These Design and Build forms are more akin to Traditional procurement, however the Employer has minimal involvement in design development, instead passing responsibility for this to the Design and Build Contractor. Package deals tend to be associated with the provision of standardised ‘off-the-shelf’ design solutions for standard building types (e.g. classrooms, temporary offices, warehouses, farm buildings). Turnkey solutions differ from package deals in that they require the Contractor to fully furnish and fit out the new facility so that it can be immediately used on handover.

Competitive Design and Build (two-stage tendering):
Proposals are developed to an initial level of design completion (typically to scheme design stage) by several tendering contractors. These initial design solutions are developed in response to a set of ‘Employer’s Requirements’ documents prepared by the Employer and its advisors. The Employer appoints a suitable tendering contractor offering a scheme design solution that it anticipates will best meet their needs. The scheme design is then adopted and completed by the appointed Contractor.

Negotiated Design and Build:
The Negotiated Design and Build projects arise when the Employer is approached by the Contractor with a project proposal that broadly aligns with the Employer’s needs. These projects are most successful when contact with the Employer is established early in the Contractor’s design development as this minimises the likelihood of any abortive design.
Develop and construct:
The Employer appoints its own consultants to initially bring the design to a more detailed stage than is normally the case (it may go so far as to detail which manufacturers’ products are to be used, for example), affording control over more of the design content. This provides a way for the Employer to increase the likelihood of its expectations regarding level of detail being met by the product. By retaining responsible for design develop for longer, the Employer does forgo many of the benefits normally associated with Design and Build.

Activity 4.1
What are the new applications for Design and Build?
Time management: 5 minutes max.

4.5 The ‘Management Contracting’ procurement route

The Management Contracting procurement route is characterised by the Employer’s appointment of a Management Contractor early in the process to advise on the design programming and buildability. The Management Contractor programmes, packages and obtains tenders for the works, which are each let on a competitive basis on lump-sum, firm-price contracts with the Management Contractor (Figure 4.3).

Management contracting has been used successfully to a limited extent since the 1920s and with increasing frequency during the 1970s and 1980s. It is generally recognised that its adoption requires mutual trust between Employers and Contractors.

Work can commence as soon as the Employer has approved the design proposals. The Management Contractor is appointed much earlier than would be possible with the Traditional approach. It becomes a member of the design team and contributes construction knowledge and management expertise. Management Contractors frequently compete at first stage tender to ensure that the Employer is charged a competitive fee for their management input. Alternatively, they can be appointed by negotiation. Once on the project, the Management Contractor is responsible for providing advice on the division of the project into work packages, each of which is normally procured by competitive tender.

‘Them and us’ attitudes are reduced and lines of communication are improved with this approach. The Management Contractor finds it easier to identify with the Employer’s needs and interests and integration of the team becomes possible. Decisions regarding the appointment of subcontractors are made jointly (by the designers and the Management Contractor) thus making use of a wider range of experience.

Specialist Contractors (or subcontractors) compete for individual work packages at second stage tender ensuring economical tenders. Contracts are entered into near the time of commencement of the works package, making firm price tenders possible. Such tenders are frequently more competitive than those submitted several months or even years ahead.
**Advantages**
- Time saving potential in overall project duration
- Buildability potential
- Breaks down traditional adversarial barriers
- Concurrent working is inherent
- Late changes easily accommodated
- Work packages let competitively

**Disadvantages**
- Needs a good quality brief
- Poor certainty of price
- Relies on a good quality project team
- May become no more than a ‘postbox’ system in certain circumstances
- Removes resistance to works contractors’ claims

**Risks**
- Medium cost risk as the actual cost is unknown until the last package is let
- Medium time risk as the total construction duration is a consequence of package selection
- Low quality/design risk because there is a close link between client, designers and constructors

**Figure 4.3: Typical project structure under the Management Contracting procurement route**

The Management Contractor’s costs are underwritten until the final approval is given and the estimated prime cost is agreed between the Management Contractor and the Employer. The prime cost of all the works packages is monitored against the estimated prime cost, but the Employer retains the cost risk on the project.
The Employer is usually given an approximate estimate of the final project cost by the Quantity Surveyor and/or Contractor early on the project life, but the final cost is not known until the last package contract is secured. Alternatively, the Management Contractor may agree to provide the project for a Guaranteed Maximum Price (GMP), thereby assuming price risk from the Employer. The Employer will pay slightly more to account for the Management Contractor’s management of this risk, but will benefit from a known financial exposure.

Under Management Constructing routes, the Architect may have less time to develop the design due to greater pressure from the Employer, Management Contractor and Works Contractors. Design quality may be compromised as a result. However, the closer working relationships required between Employer, Management Contractor and designers may allow buildability to be considered.

4.6 The ‘Construction Management’ procurement route

The Construction Management procurement route is characterised by the appointment of a Construction Manager to advise the Employer on a fee basis. The Employer then independently enters into contracts with numerous specialist contractors rather than with a main Contractor (as in Management Contracting). This gives the Employer closer involvement with the project throughout its whole life. Lines of communication between the Employer and the specialised contractors carrying out the work packages are shorter than with other systems thus ensuring a faster response to decisions. This project structure is illustrated by Figure 4.4.

As a member of the design team, the Construction Manager would be expected to co-ordinate the design and construction programmes and ensure that the interfaces between trade packages were properly considered. However, this arrangement can place the Employer at considerable risk, as ultimate responsibility for these issues may be retained by the Employer, depending on the form of contract used.

In the case of Great Eastern Hotel Co. Ltd v John Laing Co. Ltd (2005) TCC, these risks were transferred to the Employer’s consultant construction manager, as the judge decided that, although Laing were contracted to provide services only (i.e. they were not required to construct anything themselves), and therefore had different responsibilities from a traditional main or Management Contractor, they were in breach of a number of duties contained within the Construction Management agreement. Such duties included a failure to develop and manage the programme effectively, failure to include all necessary works in relevant works packages, and failure to protect existing services during demolition.
Advantages
- Time saving potential in overall project duration
- Trade packages let competitively
- Buildability potential
- Breaks down traditional adversarial barriers
- Concurrent working is inherent
- Clarity of roles, risks and relationships for all participants
- Late changes easily accommodated

Disadvantages
- No cost certainty at outset
- Needs informed client, able to take an active role in the project
- Needs a good quality brief
- Relies on a good quality project team
- Needs effective control of time and information

Sequence (not to scale)

Brief → Design → Construction

Risks
- Medium cost risk as the actual cost is unknown until the last package is let
- Medium time risks as no single organisation is solely responsible for timed completion
- Low quality-design risk because there is a close link between client, designers and constructors

Figure 4.4: Typical project structure under the Construction Management procurement route

The suitability of the Construction Management method of procurement is similar to that of Management Contracting. In summary, it is suitable for the following:

- experienced clients;
- where cost certainty is not a priority;
fast track projects;
complex buildings;
a developing brief; and
where buildability advice is required.

Specialist contractors frequently prefer to be in contract with the Employer rather than with a Management Contractor because interim payments are usually made more promptly when paid directly by the Employer. Under this form of contract, conditions can be adopted that are more appropriate to the needs of the work undertaken to share risks appropriately for each work package.

Contraction Management is a form of fast track construction as work packages for early site activities can be tendered and started on site before the design of later packages is complete.

Employers have historically encountered problems with the use of Contraction Management caused by a failure to appreciate (and therefore manage) the risks they are adopting as a consequence of taking greater responsibility for the control and coordination of the project. Use of Construction Management has reduced substantially in recent years. Appendix 4.1 presents an article discussing some of the issues, which all students should review.

4.7 The Private Finance Initiative (PFI)

4.7.1 PFI principles

Public Private Partnerships (PPPs) comprise a variety of arrangements agreed – often with legal force – between public and private sector organisations to their mutual benefit. The Private Finance Initiative (PFI) is one form of PPP developed by the Government in which the public and private sectors jointly collaborate to design, build or refurbish, finance and operate new or improved facilities and services to the general public. PFI schemes generally involve a consortium of private sector companies who collaborate to form a Special Purpose Vehicle (SPV) which then contracts with the public sector to provide services such as hospitals, schools and roads to specifications provided by public sector bodies. PFI/PPP schemes are only available to public sector clients. This procurement route is not relevant to the private sector.

Despite the broader definition of PPP, the terms PPP and PFI are often used interchangeably. For simplicity, this Unit will use the term “PFI” alone. The Office of Government Commerce defines PFI as [5]:

“Where the public sector contracts to purchase quality services, with defined outputs from the private sector on [a] long-term basis, and including maintaining or constructing the necessary infrastructure so as to take advantage of private management skills incentivised by having private finance at risk.”
This definition illustrates several key characteristics of PFI schemes:

1. A service, rather than capital assets, is purchased.

2. PFI schemes run for a long time. The public sector typically procures the provision of a service over a 25 to 35 year period.

3. Buildings or other infrastructure is usually constructed by the private sector as a consequence of the need to provide the agreed service. The PFI agreement will define the level of service required (such as providing a maintained, lit, warm, clean and catered hospital, for example) and the private sector will finance the design and construction of new or adapted facilities as necessary to accommodate that service.

4. Because the public sector is purchasing a service, rather than assets, it will not own those assets unless the transfer of their ownership is agreed when setting up the scheme.

5. Subject to any specification imposed by the public sector client, the private sector is free to use whatever means it considers appropriate when constructing the assets. This can lead to design quality and performance shortcomings.

6. The private sector puts itself at risk when securing the finance required to construct any capital assets required by the scheme. In return, it will expect to be paid for managing this risk. This raises the overall cost of PFI schemes above that of non-PFI procurement where financing risks are minimal as they are borne by the public sector with funding traditionally provided and underwritten by the Treasury.

PFI allows the infrastructure used by public services to be improved without need for the public sector to finance the (often extremely high) capital costs of construction. Further, while under contract, the risks associated with such large capital commitments are shared between the public sector and the private sector consortium, allocated according to which party is best able to manage each one.

The PFI was introduced in response to dissatisfaction with the performance of ‘traditional’ procurement. It was considered that the private sector could be incentivised to ensure the capital assets required by public sector bodies were available for use on time, to budget, of the required quality, and providing the required function by passing – where appropriate – the risks of failure for these aspects of performance to them.

By shifting the focus of procurement from acquiring capital assets to acquiring services encapsulating the provision and operation of those assets, it was further felt that a new approach to public sector procurement would allow public spending to be moved from capital expenditure to revenue expenditure. The use of PFI also allowed public sector bodies to focus on performing their specialised activities with responsibility for providing, maintaining and operating the buildings (or other infrastructure) required to accommodate those activities passed to the private sector. Public sector education authorities, for example, could focus on teaching while the private sector provided the school buildings, cleaners, caretakers, catering staff, and so on as agreed individually on each project.

As illustrated by Tables 4.2 and 4.3, the performance of PFI schemes has far exceeded that of traditional public sector infrastructure projects. As a consequence of this and the
advantages summarised above, UK Government now mandates the use of PFI on all large public sector projects following the view that “it will deliver price certainty for departments and timely delivery of good quality assets.” [6]

<table>
<thead>
<tr>
<th></th>
<th>Initial cost estimate</th>
<th>Final cost</th>
<th>Delay</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jubilee line extension</td>
<td>£2.1bn</td>
<td>£3.5bn</td>
<td>2 years</td>
</tr>
<tr>
<td>Guy’s hospital</td>
<td>£36m</td>
<td>£160m</td>
<td>3 years</td>
</tr>
<tr>
<td>Trident Faslane</td>
<td>£100m</td>
<td>£314m</td>
<td>2.5 years</td>
</tr>
</tbody>
</table>

Table 4.2: Typical cost and time overruns on large public sector infrastructure projects using non-PFI procurement

<table>
<thead>
<tr>
<th></th>
<th>Previous experience (1999 Government survey)</th>
<th>PFI experience (2002 NAO census)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction projects where cost to the public sector exceeds price agreed at contract</td>
<td>73%</td>
<td>22% 1</td>
</tr>
<tr>
<td>Construction projects delivered late to public sector</td>
<td>70%</td>
<td>24% 2</td>
</tr>
</tbody>
</table>

Notes: 1. None of the increases in PFI price after contract award were due to changes led by the consortium alone. For example, in some cases the department changed some of the specifications from those for which the consortium had bid, so the price increased to reflect the changes. Some of these specification changes arose due to new factors affecting the department’s needs after contract award. These changes would also have led to price increases under traditional procurement.

2. In only eight per cent of PFI projects surveyed was the delay more than two months. No comparative data for this statistic are available for traditionally procured projects. Previous studies of traditional projects had referred to the percentage of time overruns rather than the number of months.

Table 4.3: Comparison of time and cost performance of PFI and non-PFI procurement [7]

4.7.2 PFI procurement methods

PFI schemes are complex, comprising many agreements formed between three different types of organisation:

1. The public sector client (for example, an NHS Trust or a Local Authority)
2. The private sector provider of the required service
3. Funders and investors (senior debt and equity providers)

A single contract is established between the public sector client and a private sector company typically owned by a large construction contracting organisation specialising in PFI schemes. This company is a legal entity formed specifically for each project to provide the required service to the public sector client. It is generally referred to as the “Special Purpose Vehicle (SPV)” or “Special Purpose Company (SPC)” but is sometimes also described as the “£150 company,” reflecting the fact that it is created solely to contract with the public sector and typically has no staff, assets, or function beyond its legal purpose.
The SPV procures expertise from the construction industry. A Contracting organisation will be appointed to design and construct the solution (using the design and build procurement route) and a Facilities Management organisation will be appointed to maintain and operate the resulting assets. The SPV also secures the private sector funding required by the project, introducing the third type of organisation into the project.

Funders and investors provide the capital required to construct the assets. In return, they expect to be repaid this funding and associated finance charges, possibly also receiving dividends if they are a shareholder in the project consortium. These organisations want to ensure the scheme will succeed so that their investment will be repaid. They may consequently influence the design (to ensure the solution will perform as specified by the client so that the full revenue stream will be earned) and the maintenance and operation strategies (to ensure the assets will not unduly depreciate in value during the service period). They may also exert an influence on the management of the assets at the end of the service period.

4.7.3 The PFI consortium

A company – usually a large construction contracting organisation - assembles a “consortium” of organisations with the necessary skills and financial strength to fulfil the project requirements throughout the service period.

The consortium comprises all the organisations that collaborate to provide and facilitate the service solution. It includes the banks or capital markets (as bonds) that provide the senior debt facility (a loan representing typically 90% of the capital needed) and any other investors providing shareholder funds to make up the rest of the required capital. The consortium also includes the construction organisations that will have a long term interest in the scheme. This includes the contracting organisation that forms the SPV, negotiates the project parameters with the client, and organises the private sector input and the facilities management organisation that will maintain and operate the facility. Construction organisations that only have a short term interest in the scheme (such as the construction contractor and consultant designers, for example) are usually subcontracted to the consortium rather than being part of it.

4.7.4 The unitary charge

The agreement between the public sector client and the SPV will define a “unitary charge” charged for the provision of the serviced built asset. This payment from the public to private sector is usually made on a monthly basis.

As outlined above, the private sector must finance the capital costs of construction as well as the maintenance and operation of the asset throughout an agreed ‘service period’ of typically 25 to 35 years. Once the unitary charge is agreed, it usually cannot be revised should the private sector SPV encounter higher costs than expected. The SPV therefore needs to:

- accurately predict future expenditure so that it can be budgeted for throughout the scheme; and
- strike an appropriate balance between capital expenditure and operating costs to ensure that the public sector will receive value for money. In PFI accommodation projects, such as hospitals or prisons for example, the construction element typically represents around 25 to 30 per cent of the total value of the contract. The
The remainder of the expenditure is allocated to maintaining and operating (heating, lighting, cleaning, and so forth) the facility, and the private sector profit margin.

4.8 Prime Contracting

Although the design and build procurement method makes a single contractor responsible for the design and construct of a project, prime contracting extends this responsibility.

The Prime Contractor will be expected not only to be responsible for design and construction but also for the management and delivery of the project by co-ordinating and integrating the activities of a well established supply chain of reliable subcontractors and suppliers of quality products. The main proponents of prime contracting have been the Ministry of Defence. The Ministry of Defence operates two broad categories of prime contracts:

- The regional prime contract and
- The capital works prime contract.

Under the regional prime contract the Prime Contractor is required to design, construct and maintain particular MOD sites in a particular region. This would appear to be a form of term contract as it is usually let for a period of some 7 to 10 years.

The capital works prime contract envisages that the Prime Contractor will design and construct an asset to be fit for its life. The life of the asset is defined by reference to a specified compliance period provided by the MOD. To date prime contracting has only really been adopted by the MOD and in its current form is unlikely to be taken up as a mainstream procurement method in the way in which the PFI process has been established.

Activity 4.2

The government has stated that “Public Private Partnerships bring public and private sectors together in long term partnerships for mutual benefits”. Discuss this statement and give examples of what the benefits and opportunities might be for both the public and private sectors.

Time management: 30 minutes max.

4.9 Partnering

4.9.1 Partnering origins

Partnering has become prominent in the last decade as a procurement approach that emphasises collaborative working and problem solving over adversarial attitudes and practices. It has emerged partly in response to the shortcomings of the price-based competitive tendering of the traditional lump sum and measurement routes and partly in response to the recommendations of the Latham and Egan reports. It seeks to maximise
the benefits to all organisations of working together and can be considered in many different ways.

‘Partnering’ is thought of and implemented in a variety of ways with no single definition. It can, however, be characterised by the forming of relationships between organisations that emphasise collaboration, trust, mutual respect and common objectives; attributes that cannot be promoted in other procurement routes where cost is of key concern. Partnering relationships can be established for single projects or (more typically) span several projects undertaken by the same organisations.

Partnering is more of an operating philosophy than a unique procurement route. Any of the procurement routes described above can be implemented in a collaborative manner by adopting partnering principles.

4.9.2 Partnering principles

There are many definitions of partnering, but all contain the same basic elements alluding to the co-operation, trust, mutual objectives and improved performance that can be achieved as a result of organisations working together constructively, rather than wasting time and energy on destructive disputes. A recent UK definition summarises these principles:

“Partnering is a set of strategic actions, which embody the mutual objectives of a number of firms achieved by co-operative decision making aimed at using feedback to continuously improve their joint performance.”

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All forms of partnering rely on:

1. developing mutual objectives;
2. using simple approaches to deal with disputes; and
3. measuring continuous improvement.

Mutual objectives are formalised for clarity, and can be binding or non-binding. They tend to focus on using collaboration to improve performance, resulting in reduced costs among many other notable benefits. Partnering organisations agree how they will work together to solve problems at the outset of the relationship, with the goal always being to do so quickly and simply, using mutual respect and trust to avoid blame and dispute. Continual improvement is gauged by monitoring performance, typically using suitable Key Performance Indicators (KPIs).

Partnering encourages organisations to work collaboratively to prevent disputes. As such, it provides the fresh approach advocated by Latham for a healthy industry that does not rely on ever-more complex contract conditions to minimise the opportunity for dispute but instead fundamentally changes how organisations work together, reducing their reliance on contracts to structure their interaction.

Despite the recent simplification of most, non-partnering contract forms still consider the contracting parties to be ‘strangers’ who do not trust each other and must, therefore, rely
on precise legal definitions of their rights and responsibilities to get work done. Partnering takes the opposite view, and considers collaborating organisations as ‘friends’ who can prioritise trust over legal frameworks.

An informative summary of these partnering principles is presented in Appendix 4.2 and should be reviewed by all students.

4.9.3 Benefits of partnering

When compared with adversarial procurement routes, partnering can offer several benefits, including:

Reduced learning curve
Optimum performance and productivity can be achieved much earlier on projects due to familiarity with working practices and confidence in partners’ expertise.

Reduced abortive tendering costs
Overheads involved in tendering are reduced as competition may not be required if the client organisation is included in the partnership.

Administrative efficiency
Continuity of personnel and familiar systems of management eliminate avoidable mistakes.

Improved communications and decision procedures
Structured procedures evolving from continuous use can be relied on.

Improved quality and programming
Greater insight into the client’s objectives allows an appropriate balance to be established between them without the risk that the project team will focus on one at the expense of the others.

Economics of scale
In an ideal situation, administrative and logistic procedures can be shared across the supply chain, although such measures can be resisted if the perception that one organisations is being subsumed into another arises.

Risk
Risk identification and management is improved.

Incorporation of expertise
The increased the familiarity of organisations stimulates the inclusion of supply chain members in development of the overall solution (where contract conditions allow). Subcontractors and suppliers can be brought into the project ‘early,’ giving considerable buildability benefits and minimising the risk of abortive or unnecessary design development [8].
Problem solving
Problems can be identified at an earlier stage and brought forward for collaborative solving avoiding the potential for disputes to arise.

4.9.4 Problems with partnering
Partnering arrangements can introduce problems as well as benefits. Risks arising from the partnering arrangement itself (rather than the work being performed) can include:

Potential lack of accountability
An effective performance monitoring system is required to ensure that partnering is leading to genuine improvements and complacency is not setting in.

Unrealistic targeting
Performance targets must be realistic. In the absence of benchmarks, there is a risk that these can be set too high or too low for the nature of the partnership.

Commercial pressure
All costs and savings should be declared so that they can be shared. This requires full disclosure from all partners; something that has traditionally been difficult to obtain.

Cost attitude
Partnering organisations still have obligations, rights and duties towards each other even though the reliance on contract forms to define these is reduced. It is important that all these issues are remembered throughout the arrangement.

Change of personnel
New staff introduced to the partnership may be unfamiliar with its principles impeding their continued use.

Benefits slow to materialise
A partnership may have to function over several projects before the trust between organisations becomes sufficient to accrue notable benefit.

European Union Competition law
Partnering is unlawful if it affects freedom of movement of goods, capital, services, workers and capital.

Restrictive Trade Practices Act 1976
Agreements which impose restrictions between parties in respect of goods & services supply must be registered with the Office of Fair Trading: certain forms of partnering may fall into this category.

4.9.5 Partnering practice
Partnering is becoming more widely practised in the UK construction industry. It is a novel alternative to adversarial contracting relationships that has gained credibility from proven
success in the USA. It has been established that, in the UK, “partnered or negotiated projects are 18 to 44% more likely to deliver on cost and 7 to 15% more likely to deliver on time than those adopting historic approaches.”

Evidence from practice suggests that effective partnering exhibits three key elements: commitment; trust; and mutual benefit.

Commitment is an important element of partnering, since the unusually high degree of cooperation required means that organisations have to be committed to understanding each other and their goals.

Trust is essential as companies are sharing information and accepting a diminished control of part of their operations. Trust must be established from a mutual understanding of each other’s position and willingness to work together, acting honestly and openly. A particular project (or series of projects) will not be successful simply because the parties have signed up to work collaboratively if there is no underlying basis of trust.

Mutual benefit is a further necessary feature of partnering as organisations require more advantages and opportunities than are available in conventional commercial relationships in return for making the commitment and building the trust required by partnering.

4.10 Unit Summary

This Unit has briefly introduced the main features of alternatives to the traditional procurement route. These have been introduced to illustrate the different relationships between collaborating organisations that may be formed to respond to the client’s requirements in situations other than those to which the traditional route is an appropriate response. The influence of several factors over procurement route selection has been briefly summarised. The main features and risk distributions of several prominently used procurement routes have been introduced.

In addition to the review of common procurement routes, the main features of the public sector’s PFI procurement route have been illustrated, as have the principles on which partnering can be introduced to the procurement of a project.
4.11 References


7. ibid.